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No. 02-1859

In the Supreme Court of the United States

BOCA INVESTERINGS PARTNERSHIP, A PARTNERSHIP, AND AMERICAN HOME PRODUCTS CORPORATION, TAX MATTERS PARTNER,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

REPLY TO BRIEF IN OPPOSITION

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The question presented in the Petition is purely *legal*: Whether federal income tax law recognizes a partnership if taxpayers have a non-tax business *purpose* to form the partnership, or whether federal income tax law recognizes a partnership only if taxpayers additionally have a non-tax business *necessity* to form the partnership.

The entire Brief in Opposition reflects the Government's inability to defend the "non-tax

business necessity" requirement adopted *sua sponte*[1] by the court of appeals. In fact, instead of defending that test, the Government avoids the legal issue by claiming that the court of appeals reversed the district court's factual findings. But the district court expressly found that the Boca partnership had a business purpose, and the court of appeals rejected the Government's contention that the district court's findings were clearly erroneous. The court of appeals reversed only because it imposed a different legal requirement – that of "non-tax business necessity."

By focusing on the true nature of the court of appeals' decision, it becomes apparent that, contrary to the arguments made by the Government:

(1) the question presented is purely legal;

(2) the court of appeals' decision conflicts with the *Culbertson* decision of this Court;

(3) the court of appeals' decision conflicts with decisions of the Sixth Circuit and the Tax Court, which expressly reject a "necessity" requirement; and

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[1] *See* Pet. 6-7. The Government asserts (Opp. 9, n.7) that it did "challenge the legal standards applied by the district court in this case." That is false and is not supported by the quotations offered from the Government's brief to the court of appeals. Those quotations refer only to the Government's argument that, based on the facts of *ASA Investerings Partnership v. Commissioner*, 201 F.3d 505 (D.C. Cir. 2000), the district court's findings below were clearly erroneous. That argument was properly rejected by the court of appeals. Pet. App. 9a.

(4) the court of appeals' decision will discourage economically beneficial activity that historically has been conducted through partnerships and casts doubt on the tax treatment of a wide array of commonplace partnerships.

I. The Petition Presents the Legal Question Whether Federal Income Tax Law Requires Taxpayers To Demonstrate a Non-Tax Business Necessity To Form a Partnership.

In an attempt to make the case appear fact-bound, the Statement portion of the Government's brief begins with a seven-page description of the underlying transactions entered into by Boca and the tax accounting regulations that apply to these transactions. Opp. 2-8. But the question presented by the Petition does not turn on the facts, and the case will not require the Court to delve into a voluminous record or to apply technical regulations.

As discussed in the Petition (Pet. 7-8), the court of appeals reversed the district court "as a matter of law," Pet. App. 10a, "[b]ecause the district court did not find that a legitimate, non-tax necessity existed for the formation of the Boca Partnership," *id.* at 16a. The Government does not contend otherwise. In its description of the court of appeals' decision (Opp. 9-11), the Government quotes the same language from the court of appeals' opinion imposing a "non-tax necessity" requirement. Opp. 10. The Government also quotes the portion of the court of

appeals' opinion referring to the district court's asserted failure to make a "finding of fact in regard to the *necessity* of AHP's acquisition of foreign partners" (Opp. 10) and stating that "the judgment under review cannot stand" without "a finding on the business *need* for the partnership." Opp. 11 (emphasis added).

As the Petition (Pet. 14) points out, and as the Government does not dispute, the difference between "non-tax business necessity" and "non-tax business purpose" is not semantic – it is outcome-determinative. A partnership whose formation had a non-tax business purpose but lacked a non-tax business necessity will not be recognized under the court of appeals' test.

The Government errs in suggesting that the Court has twice declined to review the question presented by the Petition. *See* Opp. 11. The petitions for certiorari in *ACM Partnership v. Commissioner*, 157 F.3d 231 (3d Cir. 1998), and *ASA Investerings Partnership v. Commissioner*, 201 F.3d 505 (D.C. Cir. 2000), did not in any way present the question whether a non-tax business necessity is required for recognition of a partnership. *See* App. 243a-44a, *infra* (reprinting the questions presented by those petitions).[2]

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[2] As noted in the Government's opposition, *ACM* did not even involve the partnership issue. *See* Opp. 3 n.1. Furthermore, in *ASA*, unlike the instant case, the trial court found that that the parties lacked a non-tax business purpose to carry on a partnership. *See ASA Investerings P'ship v. Comm'r*, 76 T.C.M. (CCH) 325, 335 (1998). The decision of the trial court was affirmed under the "clearly erroneous" standard

The question of the legal standard for recognition of partnerships for federal income tax purposes is squarely presented by the Petition. That question should be resolved by this Court.

II. The Court of Appeals' Decision Conflicts With This Court's Decision in *Culbertson*.

The Government asserts that the court of appeals properly applied the standards established in [*Commissioner v. Culbertson*, 337 U.S. 733 (1949), and *Commissioner v. Tower*, 327 U.S. 280 (1946)] in concluding that Petitioner was not to be recognized as a valid partnership for federal tax purposes." Opp. 12. *Culbertson* and *Tower*, however, do not require a non-tax business necessity test. To the contrary, those cases establish a very different test – namely, whether "considering all the facts . . . the parties in good faith and acting with a business purpose intended to join together in the present conduct of the enterprise." *Culbertson*, 337 U.S. at 742. The failure to satisfy any particular objective inquiry "is not conclusive." *Id.* at 744. "If . . . the partners join together in good faith to conduct a business . . . that is sufficient." *Id.* at 744-45. The Government does not even attempt to argue that the court of appeals' dispositive non-tax business necessity requirement can be reconciled with the test of *Culbertson*.[3]

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of review. *See ASA Investerings P'ship v. Comm'r*, 201 F.3d 505, 516 (D.C. Cir. 2000).

[3] Regardless of whether one characterizes the necessity requirement as a separate legal test or as a dispositive, add-on legal requirement in order to establish a business purpose, the

Instead, the Government makes the erroneous allegation that the court of appeals reversed "the district court's finding that the parties in good faith and with a business purpose intended to form and did form a partnership." Opp. 12 n.8. As discussed in the Petition, the district court expressly found that the test of *Culbertson* was satisfied and that there was a non-tax business purpose for Boca.[4] This finding was *not* reversed on appeal. Rather, all of the district court's findings were approved.[5]

By requiring a finding of non-tax business necessity, the court of appeals in fact introduced a new test that makes necessity an all-determinative factor. For this reason, the decision below conflicts

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court of appeals' introduction of this new legal requirement plainly conflicts with *Culbertson*.

[4] *See* Pet. App. 188a, *quoted at* Pet. 4-5; *see also, e.g.*, Pet. App. 209a (finding that "AHP had a non-tax business purpose, namely to make investments that would generate a profit"); *id.* at 210a (stating that every credible witness "testified that from the outset AHP believed the concept to be both an investment opportunity *and* a potential tax saving opportunity."); *id.* at 78a (finding that the partnership was formed for the "purpose of making investments in notes, bonds, debentures, and other interest-bearing instruments . . . [and] sharing the profits and losses therefrom"); *id.* at 75a-82a, 139a-40a, 185a-202a.

[5] The court of appeals stated: "Although the district court reached a different conclusion than other courts had on previous occasions in cases with very similar facts, these findings of fact do not constitute clear error by the district court. The mere similarity of facts in two cases with different litigants and different evidence provides no basis for clear error on the part of either trial judge whose findings differ from the other." Pet. App. 9a.

with *Culbertson*, a decision of this Court, which is a further basis for granting review. *See* Sup. Ct. R. 10(a).

III. The Sixth Circuit and the Tax Court Have Expressly Rejected a Non-Tax Business Necessity Requirement.

In disputing that the decision below conflicts with *Miller v. Commissioner*, 183 F.2d 246 (6th Cir. 1950), and *Nichols v. Commissioner*, 32 T.C. 1322 (1959), which each apply the *Culbertson* standard, the Government argues only that each case involved a "family partnership (between a husband and wife)." Opp. 15.[6] *Culbertson*, however, sets forth the test to be used in *all* cases:

> [W]e see no reason why this general rule should not apply in tax cases where the Government challenges the existence of a partnership for tax purposes.

Culbertson, 337 U.S. at 742 (quoting *Tower*, 327 U.S. at 287). Therefore, factual differences between *Miller* and *Nichols* and the instant case are irrelevant. The

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[6] This assertion is particularly ironic given that family partnerships have historically been among the most suspect of partnerships because of the potential lack of adverse interests between the parties. *See, e.g., Tower*, 327 U.S. at 291 (noting "that transactions between husband and wife calculated to reduce family taxes should always be subjected to special scrutiny"). Moreover, the test *of Culbertson*, which was also a family partnership case, has been consistently applied for more than 50 years to all kinds of partnerships – family and otherwise – as the standard for determining which partnerships should be recognized for tax purposes.

issue is whether *Culbertson* permits a non-tax business necessity requirement.

In determining whether the partnerships there in issue should have been recognized, both *Miller* and *Nichols* expressly held that *Culbertson* prohibits a necessity requirement. *See Miller*, 183 F.2d at 253-54 (stating that the "test, of course, is not whether there is a need or obligation" to form a partnership); *Nichols*, 32 T.C. at 1330 ("The fact that the business could have been conducted just as well in some other form is not controlling.").

These holdings simply cannot be reconciled with the court of appeals' decision below. This Court should resolve the split among the circuits.[7]

IV. The Court of Appeals' "Elaborate Partnership" Limitation Fails To Prevent the Economic Harm Caused by a Non-Tax Business Necessity Test.

The Government advises that this Court need not hear this case because "[b]y its own terms, the decision in this case thus applies specifically to the use of partnerships in the context of elaborate and abusive tax avoidance schemes." Opp. 14. In arguing

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[7] The Government asserts that a conflict between a court of appeals and the Tax Court would not provide grounds for certiorari. Opp. 16 n.10. However, this Court has frequently granted certiorari to resolve conflicts between a court of appeals and the Tax Court. *See, e.g., Diedrich v. Comm'r*, 457 U.S. 191, 194 (1982); *Jewett v. Comm'r*, 455 U.S. 305, 308-09 (1982); *Comm'r v. Kowalski*, 434 U.S. 77, 82 n.11 (1977); *United States v. Generes*, 405 U.S. 93, 96 n.4 (1972).

this, of course, the Government concedes that the court of appeals departed from the longstanding, consistently applied *Culbertson* standard.

The Government is wrong, however, to assert that the court of appeals' decision is meaningfully limited by its own terms. The court of appeals stated that its decision is applicable "where taxpayers use an 'elaborate partnership,' with entities created solely for the purpose of the questioned transaction." Pet. App. 15a-16a. That limitation says nothing about tax avoidance. Furthermore, all of the economically beneficial partnerships discussed in the Petition, *see* Pet. 17-23, are "elaborate"; and, for ordinary, non-tax commercial reasons, newly created entities are commonly used in partnership transactions.

The Government does not dispute that serious economic consequences arise from throwing in doubt the tax treatment of a variety of joint economic arrangements, ranging from investment funds and business joint ventures to family partnerships. *See* Pet. 17-23. Yet that is precisely what the court of appeals has done by adopting the unprecedented requirement that there be a non-tax business necessity for recognition of a partnership.

* * *

As Justice Frankfurter noted in his concurring opinion in *Culbertson*, "The need for guarding against misuse of the outward form of a partnership as a device for obtaining tax advantages is properly

satisfied by reliance on the vigilance of the [trial court], not by distorting the concept of partnership." *Culbertson*, 337 U.S. at 753 (Frankfurter, J., concurring).

CONCLUSION

For the foregoing reasons, and the reasons stated in the Petition, a writ of certiorari should be issued.

Respectfully submitted,

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